NOVA SCOTIA Government of Nova Scotia

Backgrounder on School Leases

Department of Education and Culture (to July 99)

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SCHOOL LEASES -- RATIONALE & HIGHLIGHTS

BACKGROUND

The goals of public-private partnerships and school construction are:

- to build better schools through more school-community collaboration, linked with expertise in school design, facilities and technology; and
- to build more schools more quickly, without adding to the debt of the province.

The quality of the schools speaks for itself. The challenge is to meet nationally accepted accounting principles -- to pay and account for schools as "operating leases." Operating leases allow for payment over time, without adding to the debt of the province. As well, the province has repeatedly stated: agreements must represent good value for taxpayers over the short-and long-term.

The challenge has been met.

The lease for Nova Scotia's first elementary school (O'Connell Drive) to be designed, built, operated and financed through a public-private sector partnership has been signed by the Province, Halifax Regional School Board and Nova Learning, the private partner.

PASSING THE TESTS

To meet the requirements for an operating lease, accountants must be satisfied that enough "risk" is transferred to the private sector. Risks to be transferred are:

1. The school must be delivered on time and on budget. Any cost overruns are the responsibility of the private partner, and penalties exist for late delivery. With O'Connell Drive, this risk was fully transferred and carried by the private partner.

2. If you pay too much for a lease, you become more of an owner than a renter. Over the 20-year term of the lease, the present value of the province's lease payments cannot be 90 per cent or more of the fair market value. The O'Connell Drive Elementary lease passes this test.
3. Who knows what kind of schools will be needed, or where they will be needed, in 20 years time? The O'Connell Drive Elementary School gives the province more flexibility in meeting future

school needs, because the province has three options: to renew the lease, buy the school or walk away. The "occupancy risk" of being left with an empty building has been transferred to the private partner.

The O'Connell Drive lease meets all these tests.

VALUE FOR MONEY: LEASE vs. BORROW/BUY

To compare, the key financing concept is "time value for money." A dollar today is worth more than a dollar 20 years from now.

In the past, schools were financed by borrowing the money to buy, and attempting to repay that money over time. How does the cost of borrowing to buy compare to leasing?

Take the O'Connell Drive School example. Its fair market value is $8.05 million, representing school construction and associated project costs.

To buy the school and attempt to repay, the present value of the monthly repayment is the same as the fair market value of the school -- $8.05 million -- because we're borrowing the money today at present value. Assume the interest rate is 6.5 per cent. Therefore, monthly repayments would be about $59,000. (Note: the province's most recent long-term borrowing -- $300 million over 30 years to refinance existing debt -- attracted a 6.6 per interest rate, in October 1997.)

The present value of the lease payments, which are paid out into the future over 20 years is $7.13 million. Monthly lease payments are $51,529. (Note: the $58,829 cost reflected in the O'Connell Drive lease include $7,300 per month to finance the communications/data link connecting the school and three others. This payment was included in the lease because the link was provided by the private partner. However, that $7,300 must be subtracted from the total as reflected in the lease to arrive at the net lease cost for the school alone, of $51,529.)

Therefore, comparing apples to apples using present value, you pay $7.13 million through leasing, compared to 8.05 million to buy and repay -- in other words, over 20 years, leasing costs about $900,000 less.

If the province chooses to buy the school at a purchase price set today, again, present value comes into play. In 20 years time, the present value purchase price would be $1.12 million. Adding that to the province's lease costs, at present value ($7.13 million) and taxpayers would pay $8.24 million -- or about $200,000 more to lease and buy.

SUMMARY
Present Value of Lease Option $7.13M
Present Value of Borrow/Buy Option $8.05M
Present Value of Lease/Buy Option $8.24M

THE BOTTOM LINE

Whether you lease, buy or lease and buy, costs are comparable. Leasing costs less -- about $900,000 -- if the province walks away. Leasing would cost a little more --about $200,000 --if the province buys the school at the end of the lease, in 20 years time.

This $200,000 potential cost "buys" the province more flexibility to meet future school construction needs. Even more significantly, leasing enables the province to build more than 30 schools, much more quickly, meeting the needs of children while keeping the budget balanced and without adding debt to the province.

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